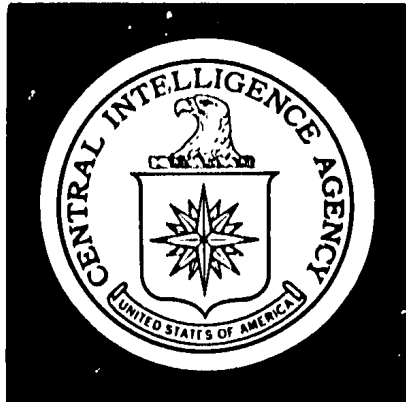


Approved For Release 2002/05/07 : CIA-RDP85T00875R001600040047-6
CIA/OER/IM 71-46 ECONOMIC TRENDS IN MALTA
25X SECRET / MARCH 1971 01 OF 01

CIA/DER/IM 71-46

Secret

25X1



**DIRECTORATE OF
INTELLIGENCE**

**DOCUMENT SERVICES BRANCH
FILE COPY
DO NOT DESTROY**

Intelligence Memorandum

*Economic Trends In Malta: An Adjustment
To The British Withdrawal*

Secret

ER IM 71-46
March 1971

Copy No. 52

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1 Excluded from automatic downgrading and declassification

~~SECRET~~

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1971

INTELLIGENCE MEMORANDUM

Economic Trends In Malta:
An Adjustment To The British Withdrawal

Introduction

Since gaining independence in 1964, Malta has had to adjust to a reduction in UK military presence by developing new sources of income. This memorandum reviews economic trends since then and assesses current economic problems and prospects.

Background

1. For centuries Malta has been a Western outpost in the center of the Mediterranean, facilitating control of the sea routes between Gibraltar, Suez, and the Bosphorus. The three relatively barren islands cover about 121 square miles of which 56% is cropland. Since the 19th century, prosperity has been linked to the presence of British military and naval bases and to the port of Valletta. The population of about 323,000 has a per capita GNP of about \$580, higher than Portugal or Turkey. For the past decade, however, Malta has been readjusting its economy to take account of its dwindling military support role. Malta has few resources other than an abundance of unskilled labor and a good climate.

The Maltese Economy

2. Many Maltese now derive their income from manufacturing (22%) -- primarily ship repairs, textiles, and food processing -- and government

Note: This memorandum was prepared by the Office of Economic Research and coordinated within CIA.

~~SECRET~~

25X1

SECRET

services (28%). Nearly 40% are employed in other services, with trade the largest employer, and only 7% earn their living from the land and fishing. A lack of economic opportunity has necessitated heavy emigration in most years since World War II. It is noteworthy that although Malta is 98% Roman Catholic, the birth rate has dropped from 2.3% to 1.6% during the past decade.

3. The country imports 80% of its food needs, as well as most capital goods and raw materials. Yet from 1965 to 1968 Malta had a balance-of-payments surplus in both current and capital accounts, despite the reduction of British expenditures and rapidly increasing imports. These surpluses were made possible by increasing exports, private transfer payments, and tourist receipts.

4. The British presence is still pervasive. The British provide development aid and budgetary support and have pledged to defend the island until 1974.* In return they have veto power over some foreign policy decisions that would otherwise be considered within the rights of a sovereign state. Malta is a member of the sterling area, the par value of the Maltese pound is pegged to the pound sterling, UK coin is legal tender, and 75% of reserves must be in sterling assets.

The Transition Period (1959-69)

5. In the 1950s the British accelerated their retrenchment of empire; in Malta this meant reducing the British garrison during a period of some tumult in Maltese politics. The question of independence for Malta had been hotly debated for some time. Strikes and demonstrations in 1959 led to the imposition of direct British rule; a new constitution was inaugurated in 1962; and independence was granted in 1964. The rundown of British defense services began in 1961 with dismissal of 1,000 of the approximately 13,000 Maltese civilians employed by the United Kingdom, an average nearly maintained during the succeeding years of the decade.

* *The United Kingdom and the Maltese government signed ten-year aid and defense agreements in 1964.*

SECRET

SECRET

6. In 1959 the contribution of the UK military to the Maltese economy was an estimated \$54 million -- 43% of gross domestic product (GDP). By 1964 these payments dropped to \$42 million and by 1969 to \$30 million, or about 20% of 1968 GDP. These expenditures were very important to the Maltese economy, but were only a part of the total economic dependence. Much of the non-military services were oriented toward the British.

7. In anticipation of the serious ramifications that British departure would have for the Maltese, a five-year development plan was drawn up and put into effect in 1959. The principal objective of both this and Malta's second development plan (FY 1965-69) was to develop industry and tourism fast enough to offset the loss of income and employment from the decreasing defense services. The core of both plans was a program of public capital expenditure with the bulk of the financing provided by the British: 73% of second plan expenditures were financed by British grants and loans.

8. Development efforts under the first plan concentrated on creating infrastructure. Progress was made in expanding electric power and water facilities, extending port and drydock facilities, and providing technical education. New industries were established and the first efforts were made to create a tourist industry. The second plan continued the policies of the first with more emphasis on investments in industry, tourism, and glasshouse horticulture. Investment in infrastructure was undertaken directly by the government. Industrial investment has been encouraged through various subsidy schemes including tax holidays, import duty exemptions, low or no interest loans and grants, and low-rent facilities in state industrial parks.

9. Economic performance under the two plans contrasts markedly. The average annual rate of growth of GDP during the first plan period was only

SECRET

~~SECRET~~

2% in current prices and even less in real terms.* The British were withdrawing at a rapid rate and independence was approaching, with attendant political turmoil. As a result, GDP actually fell in 1962 and 1963 and rose only slightly in 1964 (see Figure 1). The government, however, was laying the foundations for a resumption of economic growth, this time civilian oriented. The results of first plan efforts became evident in 1965 when the economy picked up markedly. The Maltese completed water and electricity projects, opened new industries, and obtained eye-catching results from tourist projects (see Table 1). During the first four years of the second plan period GDP grew at an average annual rate of 9.7% in current terms.** Value added by manufacturing increased an average of 12.6% annually, and that by tourism of 13.4%. The dramatic development of tourism is reflected in the 90% increase in hotel employment -- from 1,900 at the end of 1967 to 3,600 in late 1969. The tourist boom, accompanied by an increase in foreign residents, was a major factor behind a rapid expansion in construction -- an average yearly growth rate of 13.8%.

10. The improvement in the economy had a direct impact on the labor force. By 1969, unemployment and emigration had been reduced significantly (see Table 1). Unemployment peaked in 1965 with 8.2% of the labor force out of work; by 1969 this rate fell to 3.7%. Emigration, a traditional safety valve, reached a high in 1964 when almost 9,000 or 3% of the population departed, but then fell to less than 2,700 or about 1% of the population in 1969. Partly as a consequence a shortage of workers developed in certain skilled trades, especially in the construction industry.

* *There is no suitable price index for Malta. The consumer price index published by the government -- at 116 on 30 November 1970, with 1963 = 100 -- is artificially low because of government subsidies on several staple commodities that constitute a very large proportion of the items purchased by the lower income group. The rise in the standard of living in Malta in recent years with an accompanying shift in consumption patterns calls for revision of both the coverage and weighting system of the index.*

** *Data for 1969 are not yet available.*

~~SECRET~~

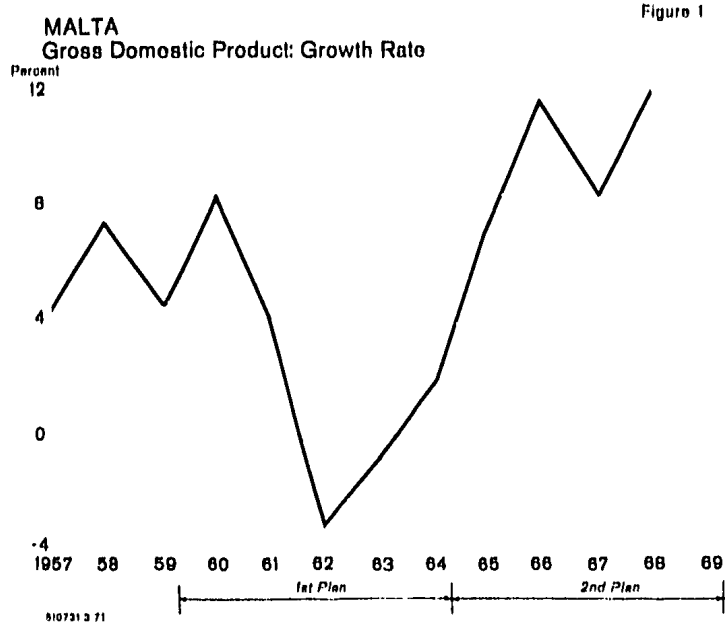
Table 1
Malta: Economic Indicators

	1959	1964	1965	1966	1967	1968	1969	1970
Employment	85,400 <u>a/</u>	86,530	88,120	90,780	93,310	95,280	99,028	N.A.
Unemployment	3,200 <u>a/</u>	7,645	7,859	6,584	5,387	4,199	3,813	N.A.
Money and quasi-money (annual percentage increase, end of year)	N.A.	4.1	5.9	1.0	11.1	13.3	15.3	11.5
Official international liquidity (million US \$)	47.6	71.5	78.9	90.2	89.5 <u>b/</u>	150.9 <u>c/</u>	139.0	157.9
Gross domestic product (million Maltese pounds, market prices)	44.5	49.2	52.7	58.8	63.7	71.3	N.A.	N.A.
Per capita GDP (US \$) (current prices)	384	426	462	519	480 <u>b/</u>	536	N.A.	N.A.
Earnings from tourism (million US \$)	-0.5	1.6	2.2	5.6	10.5	15.9	22.6	N.A.
Annual percentage change	N.A.	14.3	37.5	154.5	87.5	51.4	42.1	N.A.
Emigration	3,265	8,987	8,090	4,340	3,971	2,992	2,648	N.A.

a. Data for 1957.

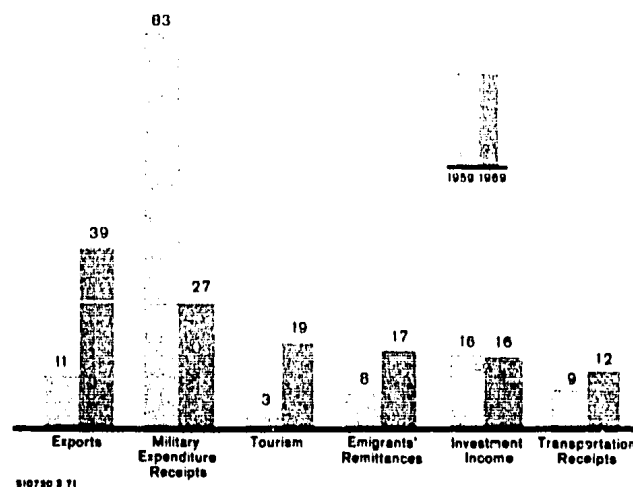
b. The Maltese pound was devalued in concert with its British counterpart in November 1967 from \$2.80 to \$2.40. This caused an equivalent drop in dollar terms of external reserves and GDP, though not in Maltese pounds.

c. The Central Bank of Malta, established in mid-1968, purchased \$53 million in sterling from the commercial banks that year, causing an abnormally large increase in official reserves. 1968 was also the year Malta joined the International Monetary Fund.



MALTA
 Current Account Receipts
 Percent of Imports, 1959 vs 1969

Figure 2



SECRET

11. The effect of development efforts on Malta's balance of payments was pronounced, indicating a considerable reduction in the economy's dependence on the UK military presence. By 1969, military receipts covered about 27% of imports (see Figure 2), compared with 83% in 1959, and exports had taken over as the most important earner of foreign exchange, with tourism increasing rapidly.

12. During the period 1960-69 prices were relatively stable; wage rates rose at an average annual rate of only 3.7%. In 1968, as the economy began to experience a shortage of skilled workers, wages began to rise rapidly, as much as 34% in some industries in that year. The resulting rise in prices did not materialize until 1969, when inflationary pressures became quite strong toward the end of the year. The ability of government authorities to control inflation with monetary policy is limited owing to the absence of a banking law.* Cooperation between the central bank and the commercial banks exists on an informal basis. Interest rates were raised from 2.5% to 3.0% on savings accounts and from 3.5% to 4.5% on time accounts in 1969, but they remained low compared with rates in London.** Fiscal policy, for its part, has been consistently expansionary. Total government expenditures have exceeded total government revenues, including foreign aid; local borrowing has covered the deficit. The imminent national election precludes for now any meaningful fiscal policy response -- for example, an austerity program or tax reforms.

* A Banking Bill has been presented to parliament.

** These rates were kept low prior to mid-1969 to protect the rate paid on deposits with the government savings bank, which had invested in low-yielding, long-term UK government paper. These investments have since been switched into higher yielding securities, and interest rates on Malta have been raised somewhat. The rationale for maintaining these low rates is to enable the government to raise capital cheaply; the government, however, is having difficulty locating willing suppliers.

SECRET

SECRET

Problems and Prospects

13. Malta has made considerable progress toward achieving its goal of economic independence from UK military activities. The sustained period of rapid growth beginning in 1965 has seen unemployment reduced to the lowest figure in a decade and the maintenance of a high level of foreign exchange reserves. Nevertheless, the government is faced with a series of problems. Several of the sources of Malta's rapid economic expansion of past years will be less favorable or unavailable in the next few years. Aid from the British has slowed down and will terminate in 1974. Rapid growth has led to pressures on the labor supply; the resulting price rises could seriously affect the competitiveness of Malta's tourist industry and its manufactured exports, especially textiles. Tourist facilities are inadequate and the industry is losing its preferential position in the United Kingdom. The Maltese drydocks have serious labor problems. Any benefits to be gained from Malta's newly signed Association Agreement with the European Communities (EC) will come later.

14. Rising costs and prices are not the only problem facing the tourist industry. The rapid growth of the past five years was poorly programmed and unbalanced. Education and training in the catering trades do not measure up to Western standards; hotel and entertainment facilities are inadequate; historical sites have not been developed; and, proper amenities, including food suitable to Western palates, are not always available. Tourists from years past have come away disappointed and Malta's reputation for recreational facilities has suffered. Many tourists have been British, attracted to Malta by the special exemption from UK restrictions on foreign exchange conversions for travel. The sharp increase in 1970 of the UK limit on foreign exchange allowances for tourists -- from \$120 to \$720 -- combined with a poor impression of Maltese facilities -- will undoubtedly affect future earnings from tourism. Indeed, since the increase in the UK allowance, Malta has suffered a sharper decline in numbers of package tours than any other sterling area country.

SECRET

SECRET

15. Malta's drydocks (see the photograph), contributing one-fifth of manufacturing output and employing over 5% of the labor force, are a special problem. They were run by the Admiralty until 1958 as a semi-welfare institution with a considerable number of redundant employees whom the government has been unable to dismiss. The drydocks have been operating at a loss since then. The shipyard was hard hit by the Suez Canal closure in 1967 and has been wracked by labor disputes that have been costly in terms of both wages and productivity. The situation has deteriorated to the point that the dockyards are no longer a net earner of foreign exchange. Because of strike losses, including contractual penalties paid to client shippers, the stated loss for FY 1970 may approach \$10 million, double that sustained in FY 1969, or about 35% of the FY 1970 capital budget. When and if the Suez Canal is reopened, the dockyards will be relatively unaffected -- the current problem is not a lack of business, but an inability to service existing customers.

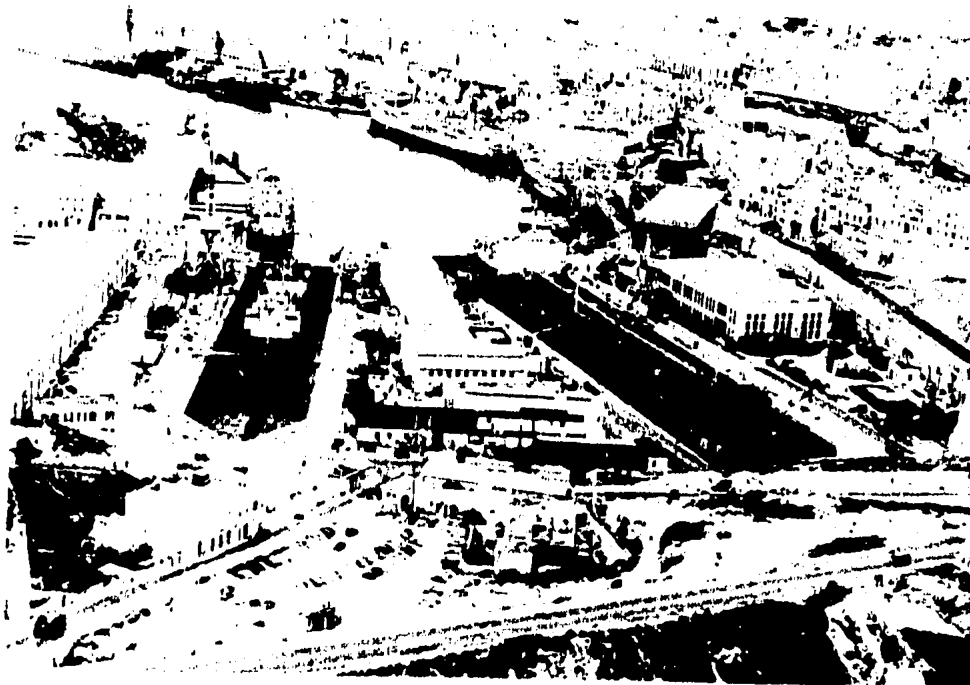


Figure 3. Malta's Drydocks

SECRET

SECRET

16. Under the 1964 Financial Assistance Agreement, the United Kingdom was to provide \$143.5 million in aid over a ten-year period. Of the total, \$55 million remains, with \$47.3 million allocated to cover 40% of the government's future economic development outlays. There has been little aid from other countries and, other than an Italian government loan of \$4.8 million to finance part of the investment plans of the Malta Electricity Board, not much is expected.

17. Malta has not taken full advantage of the assistance available through multilateral organizations. The government joined the International Monetary Fund in late 1968 but has yet to join the International Bank for Reconstruction and Development (IBRD). Although, before Maltese independence, the IBRD extended a \$6.5 million loan guaranteed by the British, the Maltese have not met their repayment obligations, and they seem unlikely to join the World Bank until this issue has been resolved. The relatively high per capita income of the islands would make it a low priority country for nearly interest-free International Development Association credits, but IBRD loans could help finance development projects. The UN Development Program is funding several projects in Malta, but these customarily total only about \$200,000 per year.

18. Efforts to mobilize domestic resources pivot on the third five-year plan (FY 1970-74),* which calls for public expenditures of \$118 million (see Table 2). The primary targets of plan expenditures are industrial development (17.4%), housing (10.6%), water (9.4%), tourism (9.3%), and roads (9.2%). The main thrust of the industrial development program is aimed at reducing costs by providing subsidies,

** Its publication -- though not implementation -- was delayed more than a year owing to a dispute between Malta and the United Kingdom over the proportion of aid between grants and loans. The United Kingdom insisted that the loan proportion be raised to 50% from the 25% that obtained previously. The Maltese government balked, resorting to short-term borrowing on the domestic market to undertake the plan. This dispute was finally resolved in October 1970 when the British acceded to the Maltese demands to continue the 75/25 grant/loan ratio.*

SECRET

Table 2

Malta: Third Five-Year Plan -- Expenditure
and Financing

	Million US \$
Public development expenditure	118.1
Less estimated delays <u>a/</u>	19.2
<i>Total</i>	<i>98.9</i>
Proposed Financing	
United Kingdom	47.3
Local loan sources <u>b/</u>	50.2
Foreign loans <u>c/</u>	1.4

a. Because of delays in presentation of bills and physical implementation, the government estimates that it will not need to finance this sum during the plan period.

b. If additional foreign soft loans are negotiated, local borrowing will be correspondingly reduced.

c. Excluding a \$4.8 million loan from Italy for the Electricity Board.

grants, and exemptions. In an effort to counter the effects of poor past performance and rising prices, the government has allocated \$11 million to develop tourism further. These funds will be used for promotional campaigns, loans and grants to hotels, and the cost of complimentary municipal infrastructure. Excluding the promotional campaign, the program will provide facilities for a growing influx of tourists, but what Malta's tourist industry most needs is an upgrading of existing services with more funds allocated to technical training.

19. The plan takes into account the Association Agreement with the EC. At present the United Kingdom dominates Malta's trade; it is hoped Malta's export markets (see Table 3) will be expanded by the treaty with the EC. The agreement, effective on 1 April 1971, provides for an eventual customs union between the two parties. Whether or not the union will

SECRET

SECRET

Table 3

Malta: Foreign Trade
1969

	Percent
Direction of trade	
Imports	
EC	29.7
United Kingdom	42.5
Other	27.8
<i>Total</i>	<i>100.0</i>
Exports	
EC	25.6
United Kingdom	34.4
Other	40.0
<i>Total</i>	<i>100.0</i>
Composition of trade	
Imports	
Industrial supplies	39.4
Capital goods	16.8
Consumer goods	43.0
Other	0.8
<i>Total</i>	<i>100.0</i>
Exports	
Agricultural	7.4
Manufactures	88.6
Other	4.0
<i>Total</i>	<i>100.0</i>

benefit Malta will depend on the competitiveness of its manufactured items. The agreement places a low quota on textiles, which now account for one-fifth of manufacturing output and approximately one-half of exports. To take advantage of the agreement, the range of Maltese manufacturing activity will have to expand, but there is no provision for EC financial aid.

20. Although not specifically as part of the plan, Malta is considering legislation to boost foreign exchange earnings by accommodating certain groups seeking to avoid heavy taxes or legal strictures. The Exempted Companies Act, designed to give Malta the status of a tax haven country similar to Luxembourg and Liechtenstein, would allow the establishment of offshore investment and financial management companies.* Although under consideration for the past five years, this bill has not been presented to parliament. Meanwhile, parliament is considering legislation that would partly exempt specified commercial banks -- those involved in raising cash abroad for investment abroad -- from income tax on profits earned on these transactions. The fate of the broader tax haven legislation is expected to hinge on the successful operation of the current proposal over a period of time. "Flag of convenience" legislation has also been deliberated for several years; there is no chance that it will be passed prior to the elections, and probably not before 1972. Considering the experience of countries with similar laws, the economic benefits likely to accrue to Malta from their enactment will probably be minimal.

21. The Maltese have an estimated half billion dollars or so invested abroad, primarily in the United Kingdom. These funds are at least nine times the total British aid available for the third plan. In addition, Maltese citizens maintain significant funds of idle local money. A strenuous government program to repatriate these funds and reduce the outflow of current savings would probably achieve some success. (The Minister of Finance has the power to prohibit capital transactions involving the exchange of Maltese pounds for the currency of other

* These companies are incorporated in one country while their investments and, usually, their investors are located elsewhere.

SECRET

countries of the sterling area as well as non-sterling countries.) Issues of Malta Local Development Registered Stock are sold by the central bank, but there is no organized market for private securities. The government has been considering establishing a stock exchange since 1968 when a committee was appointed to study the feasibility of such a project.

25X6

Conclusions

23. For the near term, buoyed by the public investment program, Malta's economy should continue to grow at close to the 10% rate of the late 1960s. In 1969, GNP increased an estimated 13.7% in real terms, and in 1970 the economy probably grew at a high (although somewhat lower) rate. The immediate difficulties in sustaining this rate include financing a related large import bill, relieving the shortage of skilled workers, and curbing excessive union wage demands. Until the mid-1970s, foreign aid -- mainly British -- should be sufficient to prevent serious deterioration in the external payments accounts. A more lenient policy toward the issuing of work permits to foreigners would satisfy the immediate need for skills. Controlling the unskilled work force is more difficult, and the government has shown no willingness to deal with this politically difficult problem. The inflationary pressures, unless contained, could undermine the international competitiveness of Maltese exports and tourism and, in turn, growth in the longer term.